

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON THE MBIZANA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mbizana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer opinion

Property, plant and equipment

4. Sufficient appropriate audit evidence was not available for both the current and prior years as follows:
 - Documentation in support of adjustments to property, plant and equipment (PPE), impairment gains, depreciation and other changes include in note 4 to the financial statements were not submitted for audit purposes.
 - The fixed asset register of the municipality did not agree to the underlying accounting records and the financial statements.
 - Useful lives and residual values of infrastructure assets were not reviewed at the end of the reporting period.
 - The municipality did not assess impairment of its PPE in accordance with GRAP 21 *Impairment of non-cash generating assets*.

I was unable to confirm the assets balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to PPE of R285,9 million (2013:R263,3 million) as disclosed in note 3 to the financial statements.

Irregular expenditure

5. The municipality did not have adequate systems to identify and disclose all irregular expenditure incurred during the current and prior year and to ensure that all irregular expenditure incurred was in terms of the definition, as required by section 125(2)(d)(i) of the MFMA. As a result I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure as disclosed in note 44 to the financial statements were necessary.

Depreciation and amortisation

6. Sufficient appropriate audit evidence was not available to support depreciation for both the current and prior years disclosed in the financial statements. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments to the depreciation and amortisation figure stated at R19,0 million (2013:R25,2 million) in the financial statements were necessary.

Payables from exchange transactions

7. Sufficient appropriate audit evidence was not available for documentation in support of payables from exchange transactions disclosed in the financial statements. I was unable to confirm payables from exchange transactions by alternative means due to the inadequate document management system. Consequently, I was unable to determine whether any further adjustments were necessary to payables from exchange transactions of R27,5 million (2013:R29,4 million) as disclosed in the statement of financial position.

Commitments

8. An adequate and complete record of commitments was not maintained and reviewed for accuracy by the municipality for the year under review as required by section 95 (b) of the MFMA. Consequently, commitments as disclosed in note 34 to the financial statements is understated by R4,8 million.

Aggregation of immaterial uncorrected misstatements

9. The financial statements as a whole are materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following elements:

Making up and as disclosed in the statement of financial position:

- Unspent conditional grants of R4,9 million included in note 14 of the financial statements is understated by R718 574.

Making up and as disclosed in the statement of financial performance:

- General expenses included in note 23 to the financial statements are overstated by R591 500.
- Personnel costs of R51,2 million included in note 24 to the financial statements is understated by R1,3 million.

10. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to the following elements:

Making up and as disclosed in the statement of financial position:

- Inventory included in the financial statements

- VAT receivable included in the financial statements

Making up and as disclosed in the statement of financial performance:

- General expenses included in the financial statements

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Prior Year Figures

11. During the prior year, I identified the following misstatements which are still included in the prior year figures disclosed in the current period's financial statements:
12. My opinion on the current period's financial statements is modified because of the possible effects of these matters on the comparability of the current period's figures:

Grant related expenditure

13. The municipality did not maintain accurate records of outstanding payments for goods and services received but not yet paid at year-end as required by the financial reporting framework. As a result invalid accruals and expenditure raised in the wrong accounting period were included in grant related expenditure. This resulted in the overstatement of grant related expenditure as disclosed in note 32 amounting to R7,6 million and overstatement of trade and other payables.

Personnel Costs

14. Sufficient appropriate audit evidence was not available to support personnel costs disclosed in the prior year financial statements and adjustments processed to the prior year figures during the current financial year were unsupported. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment to the prior year personnel costs figure stated at R44,5 million in the financial statements was necessary.

Unauthorised expenditure

15. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the prior year as required by section 95 (b) of the MFMA. Due to the lack of systems it was impracticable for me to determine the full extent of the understatement. Consequently, I was unable to determine whether any adjustment to the prior year unauthorised expenditure figure stated at R9,5 million in the financial statements was necessary.

Commitments

16. The municipality did not have adequate systems in place to identify and disclose all commitments outstanding during the prior year. Due to lack of systems, I could not determine the completeness of commitments by alternative means. Consequently, I was unable to determine whether any adjustment to the prior year commitments figure stated at R44,6 million in the financial statements was necessary.

Aggregation of immaterial uncorrected misstatements in prior year figures

17. The financial statements as a whole are materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following elements:

Making up and as disclosed in the statement of financial position:

- Allowance for impairment is understated by R1,1million
- Investment property is overstated by R1,3 million
- VAT receivable is overstated by R1,3 million

Making up and as disclosed in the statement of financial performance:

- General expenditure is overstated by R1,3 million
- Fair value loss is overstated by R1,3 million

18. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to the following elements included in prior year figures:

Making up and as disclosed in the statement of financial position:

- Receivables from exchange transactions included in the financial statements.
- Cash and cash equivalents included in the financial statements.

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Disclaimer of opinion

19. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

20. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

21. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the Mbizana Local Municipality at, and for the year ended, 30 June 2013.

Material impairments

22. As disclosed in note 6 and 7 to the financial statements, cumulative provisions for impairments of R2,9 million (2013: R2,2 million) relating to receivables from non-exchange transactions and R6,7 million (2013:R6,6 million) relating to receivables from exchange transactions were incurred as a result of irrecoverable trade debtors.

23. As disclosed in the statement of financial performance and note 26 to the financial statements, debt impairments totalling R3 million (2013:R5 million) have been expensed.

Material losses

24. As disclosed in note 47 to the financial statements, material losses to the amount of R5,6 million (2013:R5,3 million) were incurred as a result of electricity losses.

Irregular and fruitless and wasteful expenditure

25. As disclosed in notes 43 and 44 to the financial statements, fruitless and wasteful expenditure of R430 604 (2013:R115 948) and irregular expenditure of R5,6 million (2013:R7,9 million) were incurred as a result of interest on late payment of suppliers and contravention of the supply chain management policy and legislation.

Additional matters

26. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

27. The supplementary information set out on pages xx to xx, does not form part of the financial statements and is presented as additional information. I have not audited these schedules, except for Appendix E (Actual vs Budget) and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

28. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

29. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

30. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Development priority 5: Engineering Services
- Development priority 6: Community Services

31. I evaluated the reported performance information against the overall criteria of usefulness

and reliability.

32. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
33. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
34. The material findings in respect of the selected development priorities are as follows:

Development priority 5: Engineering Services

Usefulness of reported performance information

Measurability of indicators

35. The FMPPI requires the following performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 27% of the indicators which are significantly important indicators in relation to the Municipality's operations were not verifiable. This was because management did not adhere to the requirements of the FMPPI and there was a lack of proper systems and processes and technical indicator descriptions.

Reliability of reported performance information

36. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Development priority 6: Community Services

Usefulness of reported performance information

Measurability of indicators

37. The FMPPI requires the following:
- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 28% of the targets were not specific.
 - Performance targets must be measurable. We could not measure the required performance for 28% of the targets.
 - Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 26% of the indicators were not well defined.

- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 23% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI and there was a lack of proper systems and processes and technical indicator descriptions.

Reliability of reported performance information

38. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Overall, 45,1% of the targets or significantly important targets were not reliable because I was unable to obtain sufficient appropriate audit evidence for significantly important targets. In addition significantly important targets were not valid, accurate and complete when compared to the source information or evidence provided.

Additional matters

39. I draw attention to the following matters:

Achievement of planned targets

40. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 34 to 38 of this report.

Adjustment of material misstatements

41. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for development priority 5: engineering services and development priority 6: community services. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Unaudited supplementary information

42. The supplementary information set out on pages xx to xx does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

43. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

44. The municipality established mechanisms to monitor and review its performance

management system, as required by section 40 of the section 41(1)(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), however they were not effective due to control deficiencies which resulted in material misstatements of predetermined objectives.

45. The performance management system did not provide for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the MSA.
46. Measurable performance targets for the financial year with regard to each of the objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations, 2001 (Government Gazette 22605 of 2001) (MPPMR) 12(1) and 12(2)(e).
47. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the MPPMR.
48. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Annual financial statements and annual report

49. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013-14 annual report was tabled, as required by section 129(1) of the MFMA.
50. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of , general expenditure, payables from exchange transactions, PPE and commitments identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently but the uncorrected material misstatements and supporting records that could not be provided, which resulted in the financial statements receiving a disclaimer.

Asset management

51. An effective system of internal control for assets including an asset register was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

52. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
53. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Expenditure management

54. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

55. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.
56. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Human resources management

57. The senior managers for Community Development and Engineering Services were appointed without having met the prescribed minimum competency levels as required by section 56 (1)(b) of the MSA.
58. Sufficient appropriate audit evidence could not be obtained that the senior managers dismissed for financial misconduct in a previous position and re-appointed before the expiry of 10 years in contravention of section 57A of the MFMA.
59. Managers directly accountable to the municipal manager were appointed without submitting proof of previous employment and disclosure of financial interests in contravention of regulation 4 of GNR 805.
60. Two senior managers did not meet any of the prescribed competency areas as required by regulation 6 and 7 of the Municipal Regulations on Minimum Competency Levels and Finance official at middle management (manager revenue & expenditure) did not meet any of the prescribed competency areas as required by regulation 8 and 9 of the Municipal Regulations on Minimum Competency Levels.
61. The municipality did not develop and adopt appropriate systems or policies and procedures to monitor, measure and evaluate performance of staff in contravention of MSA sec 67(d).

Audit committee

62. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
63. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
64. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
65. The audit committee did not advise the council on matters relating to performance management and performance evaluation as required by section 166(2)(a) of the MFMA.

Internal audit

66. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act, in that it did not advise the accounting officer and report to the audit committee on matters relating to accounting procedures and loss control.

Consequence management

67. Irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
68. Irregular and fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
69. Council certified irregular expenditure as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(a)(ii) of the MFMA.

Procurement and contract management

70. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as information for the procurement processes followed could not be provided by management due to inadequate co-ordination and filing of information requested for the audit.
71. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the Accounting Officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
72. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
73. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44.
74. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the Construction Industry Development Board Act of South Africa, 2000 (Act no 38 of 2000) and CIDB regulation 18.
75. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.

Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

77. The municipality had a formal code of conduct in place that was communicated to all employees. However, the control environment was ineffective as material instances of non compliance with laws and regulations, adjustments to the financial statements and annual performance report submitted for audit were identified during the audit.
78. There was a lack of consequences for transgression to compliance with the relevant laws and regulations as no steps were taken to identify persons liable for fruitless and wasteful expenditure and irregular expenditure.
79. Most senior managers were not part of the municipality for part of the year resulting in a negative impact on the control environment of the municipality. The municipality had significant number of senior management vacancies which were only filled in January 2014.

Financial and performance management

80. Management did not adequately review financial statements and the report on performance before submission for audit. This resulted in various misstatements in the financial statements and annual performance report submitted for audit. Senior management did not adequately respond to our recommendations resulting in internal controls regressing.
81. The municipality did not have a proper record management system or an approved record classification system to maintain information that supported the reported performance in the annual performance report. This included information that related to the collection, collation, verification, storing and reporting of actual performance information.

Governance

82. The audit committee met prior to the submission of the financial statements to review the adequacy, reliability and accuracy of the financial statements. However, the review on the financial statements and compliance with laws and regulations was not adequate as evidenced by material misstatements identified.
83. The internal audit unit did not adequately review financial and performance reports to confirm the reliability of the reports before their submission to the audit committee or external auditors.

OTHER REPORTS

Investigations

84. There are current investigations on criminal allegations for alleged fraudulent payments to a contractor for services not rendered. The allegations are being investigated by the Directorate of Priority Crimes Unit (Hawks) after the matter was referred by the National Treasury. The matter is still being finalised.

Auditor-General

East London

3 December 2014



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SOUTH AFRICA

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